Has globalization gone too far?

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Authors: Dani Rodrik
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Abstract:
The process that has come to be known as "globalization" is exposing a deep fault line between groups who have the skills and mobility to flourish in global markets and those who either do not have these advantages or perceive the expansion of unregulated markets as inimical to social stability and deeply held norms. The result is severe tension between the market and social groups such as workers, pensioners, and environmentalists, with governments stuck in the middle. The most serious challenge for the world economy in the years ahead lies in making globalization compatible with domestic social and political stability - or to put it even more directly, in ensuring that international economic integration does not contribute to domestic social disintegration.

Full Text:

Labor strikes in France at the end of 1995, which were aimed at reversing the French government's efforts to bring its budget in line with the Maastricht criteria, threw the country into its worst crisis since 1968. Around the same time in the United States, a prominent Republican was running a vigorous campaign for the presidency on a plank of economic nationalism, promising to erect trade barriers and tougher restrictions on immigration. In the countries of Eastern Europe and in Russia, former communists have won most of the parliamentary elections held since the fall of the Berlin Wall, and communist candidate Gennady Zyuganov garnered 40 percent of the vote in the second round of the Russian presidential election held in July 1996.

These apparently disparate developments have one common element: the international integration of markets for goods, services, and capital is pressuring societies to alter their traditional practices, and in return broad segments of these societies are putting up a fight.[1] The pressures for change are tangible and affect all societies: In Japan, large corporations have started to dismantle the postwar practice of lifetime employment, one of Japan's most distinctive social institutions. In Germany, the federal government has been fighting union opposition to cuts on pension benefits aimed at improving competitiveness and balancing the budget. In South Korea, trade unions have gone on nationwide strikes to protest new legislation making it easier for firms to lay off workers. Developing countries in Latin America have been competing with each other in opening up to trade, deregulating their economies, and privatizing public enterprises. Ask business executives or government officials why these changes are necessary, and you will hear the same mantra repeatedly: "We need to remain (or become) competitive in a global economy."

The opposition to these changes is no less tangible and sometimes makes for strange bedfellows. Labor unions decrying unfair competition from underage workers overseas and environmentalists are joined by billionaire businessmen Ross Perot and Sir James Goldsmith in railing against the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO). In the United States, perhaps the most free-market-oriented of advanced industrial societies, the philosophical foundations of the classical liberal state have come under attack not only from traditional protectionists but also from the new communitarian movement, which emphasizes moral and civic virtue and is inherently suspicious of the expansion of markets.2

The process that has come to be called "globalization" is exposing a deep fault line between groups who have the skills and mobility to flourish in global markets and those who either don't have these advantages or perceive the expansion of unregulated markets as inimical to social stability and deeply held norms. The result is severe tension between the market and social groups such as workers, pensioners, and environmentalists, with governments stuck in the middle.3

This article argues that the most serious challenge for the world economy in the years ahead lies in making globalization compatible with domestic social and political stability-or to put it even more directly, in ensuring that international economic integration does not contribute to domestic social disintegration. Attuned to the anxieties of their voters, politicians in the advanced industrial countries are well aware that all is not well with globalization. The Lyon summit of the Group of Seven, held in June 1996, gave the issue central billing: its communique was titled "Making a Success of Globalization for the Benefit of All." The communique opened with a discussion of globalization-its challenges as well as its benefits. The leaders recognized that globalization raises difficulties for certain groups, and they wrote:

In an increasingly interdependent world we must all recognize that we have an interest in spreading the benefits of economic growth as widely as possible and in diminishing the risk either of excluding individuals or groups in our own economies or of excluding certain countries or regions from the benefits of globalization.

But how are these objectives to be met?

An adequate policy response requires an understanding of the sources of the tensions generated by globalization. Without such an understanding, the reactions are likely to be of two kinds. One is of the knee-jerk type, with proposed cures worse than the disease. Such certainly is the case with blanket protectionism a la Patrick Buchanan or the abolition of the WTO a la Sir James Goldsmith. Indeed, much of what passes as analysis (followed by condemnation) of international trade is based on faulty logic and misleading empirics.4 To paraphrase Paul Samuelson, there is no better proof that the principle of comparative advantage is the only proposition in economics that is at once true and nontrivial than the long history of misunderstanding that has attached to the consequences of trade. The problems, while real, are more subtle than the terminology that has come to dominate the debate, such as "low-wage competition," or "leveling the playing field," or "race to the bottom." Consequently, they require nuanced and imaginative solutions.

The other possible response, and the one that perhaps best characterizes the attitude of much of the economics and policy community, is to downplay the problem. Economists' standard approach to globalization is to emphasize the benefits of the free flow of goods, capital, and ideas and to overlook the social tensions that may result.5 A common view is that the complaints of nongovernmental organizations or labor advocates represent nothing but old protectionist wine in new bottles. Recent research on trade and wages gives strength to this view: the available empirical evidence suggests that trade has played a somewhat minor role in generating the labor-market ills of the advanced industrial countries-that is, in increasing income inequality in the United States and unemployment in Europe.6

While I share the idea that much of the opposition to trade is based on faulty premises, I also believe that economists have tended to take an excessively narrow view of the issues. To understand the impact of globalization on domestic social arrangements, we have to go beyond the question of what trade does to the skill premium. And even if we focus more narrowly on labor-market outcomes, there are additional channels, which have not yet come under close empirical scrutiny, through which increased economic integration works to the disadvantage of labor, and particularly of unskilled labor. This article attempts to offer such a broadened perspective. As we shall see, this perspective leads to a less benign outlook than the one economists commonly adopt. One side benefit, therefore, is that it serves to reduce the yawning gap that separates the views of most economists from the gut instincts of many laypeople.

Sources of Tension

I focus on three sources of tension between the global market and social stability and offer a brief overview of them here.

First, reduced barriers to trade and investment accentuate the asymmetry between groups that can cross international borders (either directly or indirectly, say through outsourcing) 7 and those that cannot. In the first category are owners of capital, highly skilled workers, and many professionals, who are free to take their resources where they are most in demand. Unskilled and semiskilled workers and most middle managers belong in the second category. Putting the same point in more technical terms, globalization makes the demand for the services of individuals in the second category more elastic-that is, the services of large segments of the working population can be more easily substituted by the services of other people across national boundaries. Globalization therefore fundamentally transforms the employment relationship.

The fact that "workers" can be more easily substituted for each other across national boundaries undermines what many conceive to be a postwar social bargain between workers and employers, under which the former would receive a steady increase in wages and benefits in return for labor peace. This is because increased substitutability results in the following concrete consequences: Workers now have to pay a larger share of the cost of improvements in work conditions and benefits (that is, they bear a greater incidence of nonwage costs).

They have to incur greater instability in earnings and hours worked in response to shocks to labor demand or labor productivity (that is, volatility and insecurity increase).

Their bargaining power erodes, so they receive lower wages and benefits whenever bargaining is an element in setting the terms of employment. These considerations have received insufficient attention in the recent academic literature on trade and wages, which has focused on the downward shift in demand for unskilled workers rather than the increase in the elasticity of that demand.

Second, globalization engenders conflicts within and between nations over domestic norms and the social institutions that embody them. As the technology for manufactured goods becomes standardized and diffused internationally, nations with very different sets of values, norms, institutions, and collective preferences begin to compete head on in markets for similar goods. And the spread of globalization creates opportunities for trade between countries at very different levels of development.

This is of no consequence under traditional multilateral trade policy of the WTO and the General Agreement on Tariffs and Trade (GATT): the "process" or "technology" through which goods are produced is immaterial, and so are the social institutions of the trading partners. Differences in national practices are treated just like differences in factor endowments or any other determinant of comparative advantage. However, introspection and empirical evidence both reveal that most people attach values to processes as well as outcomes. This is reflected in the norms that shape and constrain the domestic environment in which goods and services are produced-for example, workplace practices, legal rules, and social safety nets.

Trade becomes contentious when it unleashes forces that undermine the norms implicit in domestic practices. Many residents of advanced industrial countries are uncomfortable with the weakening of domestic institutions through the forces of trade, as when, for example, child labor in Honduras displaces workers in South Carolina or when pension benefits are cut in Europe in response to the requirements of the Maastricht treaty. This sense of unease is one way of interpreting the demands for fair trade." Much of the discussion surrounding the new" issues in trade policy-that is, labor standards, environment, competition policy, corruption-can be cast in this light of procedural fairness.

We cannot understand what is happening in these new areas until we take individual preferences for processes and the social arrangements that embody them seriously. In particular, by doing so we can start to make sense of people's uneasiness about the consequences of international economic integration and avoid the trap of automatically branding all concerned groups as self-interested protectionists. Indeed, since trade policy almost always has redistributive consequences (among sectors, income groups, and individuals), one cannot produce a principled defense of free trade without confronting the question of the fairness and legitimacy of the practices that generate these consequences. By the same token, one should not expect broad popular support for trade when trade involves exchanges that clash with (and erode) prevailing domestic social arrangements.

Third, globalization has made it exceedingly difficult for governments to provide social insurance-one of their central functions and one that has helped maintain social cohesion and domestic political support for ongoing liberalization throughout the postwar period. In essence, governments have used their fiscal powers to insulate domestic groups from excessive market risks, particularly those having an external origin. In fact, there is a striking correlation between an economy's exposure to foreign trade and the size of its welfare state. It is in the most open countries, such as Sweden, Denmark, and the Netherlands, that spending on income transfers has expanded the most. This is not to say that the government is the sole, or the best, provider of social insurance. The extended family, religious groups, and local communities often play similar roles. My point is that it is a hallmark of the postwar period that governments in the advanced countries have been expected to provide such insurance.

At the present, however, international economic integration is taking place against the background of receding governments and diminished social obligations. The welfare state has been under attack for two decades. Moreover, the increasing mobility of capital has rendered an important segment of the tax base footloose, leaving governments with the unappetizing option of increasing tax rates disproportionately on labor income. Yet the need for social insurance for the vast majority of the population that remains internationally immobile has not diminished. If anything, this need has become greater as a consequence of increased integration. The question therefore is how the tension between globalization and the pressures for socialization of risk can be eased. If the tension is not managed intelligently and creatively, the danger is that the domestic consensus in favor of open markets will ultimately erode to the point where a generalized resurgence of protectionism becomes a serious possibility.

Each of these arguments points to an important weakness in the manner in which advanced societies are handling-or are equipped to handle-the consequences of globalization. Collectively, they point to what is perhaps the greatest risk of all, namely that the cumulative consequence of the tensions mentioned above will be the solidifying of a new set of class divisions-between those who prosper in the globalized economy and those who do not, between those who share its values and those who would rather not, and between those who can diversify away its risks and those who cannot. This is not a pleasing prospect, even for individuals on the winning side of the divide who have little empathy for the other side. Social disintegration is not a spectator sport-those on the sidelines also get splashed with mud from the field. Ultimately, the deepening of social fissures can harm all.

Globalization: Now and Then

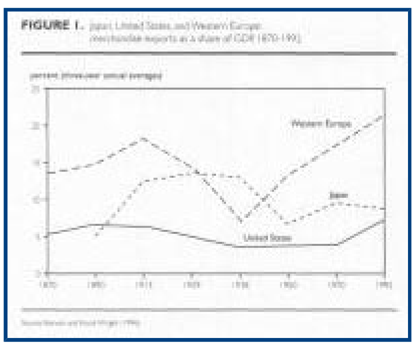

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FIGURE I.

This is not the first time we have experienced a truly global market. By many measures, the world economy was possibly even more integrated at the height of the gold standard in the late 19th century than it is now. Figure 1 charts the ratio of exports to national income for the United States, Western Europe, and Japan since 1870. In the United States and Europe, trade volumes peaked before World War I and then collapsed during the interwar years. Trade surged again after 1950, but none of the three regions is significantly more open by this measure now than it was under the late gold standard. Japan, in fact, has a lower share of exports in GDP now than it did during the interwar period.

Other measures of global economic integration tell a similar story. As railways and steamships lowered transport costs and Europe moved toward free trade during the late 19th century, a dramatic convergence in commodity prices took place.8 Labor flows were considerably higher then as well, as millions of immigrants made their way from the old world to the new. In the United States, immigration was responsible for 24 percent of the expansion of the labor force during the 40 years before World War I.9 As for capital mobility, the share of net capital outflows in GNP was much higher in the United Kingdom during the classical gold standard than it has been since.

Does this earlier period of globalization hold any lessons for our current situation? It well might. There is some evidence, for example, that trade and migration had significant consequences for income distribution. According to Jeffrey Williamson, "[G]lobalization . . . accounted for more than half of the rising inequality in rich, labor-scarce countries [e.g., the United States, Argentina, and Australia] and for a little more than a quarter of the falling inequality in poor, labor-abundant countries [e.g., Sweden, Denmark, and Ireland]" in the period before World War I.lo Equally to the point are the political consequences of these changes:

There is a literature almost a century old that argues that immigration hurt American labor and accounted for much of the rise in inequality from the 1890s to World War I, so much so that a labor-sympathetic Congress passed immigration quotas. There is a literature even older that argues that a New World grain invasion eroded land rents in Europe, so much so that landowner-dominated Continental Parliaments raised tariffs to help protect them from the impact of globalization.11

Williamson concludes that the inequality trends which globalization produced are at least partly responsible for the interwar retreat from globalization [which appeared] first in the rich industrial trading partners.'"2 Moreover, there are some key differences that make today's global economy more contentious. First, restrictions on immigration were not as common during the 19th century, and consequently labor's international mobility was more comparable to that of capital. Consequently, the asymmetry between mobile capital (physical and human) and immobile "natural" labor, which characterizes the present situation, is a relatively recent phenomenon. Second, there was little head-on international competition in identical or similar products during the previous century, and most trade consisted of the exchange of noncompeting products, such as primary products for manufactured goods. The aggregate trade ratios do not reflect the "vast increase in the exposure of tradable goods industries to international competition" that is now taking place compared with the situation in the 1890s."3 Third, and perhaps most important, governments had not yet been called on to perform social-welfare functions on a large scale, such as ensuring adequate levels of employment, establishing social safety nets, providing medical and social insurance, and caring for the poor. This shift in the perceived role of government is also a relatively recent transformation, one that makes life in an interdependent economy considerably more difficult for today's policymakers.

At any rate, the lesson from history seems to be that continued globalization cannot be taken for granted. If its consequences are not managed wisely and creatively, a retreat from openness becomes a distinct possibility. Implications

So has international economic integration gone too far? Not if policymakers act wisely and imaginatively.

We need to be up front about the irreversibility of the many changes that have occurred in the global economy. Advances in communications and transportation mean that large segments of national economies are much more exposed to international trade and capital flows than they have ever been, regardless of what policymakers choose to do. There is only limited scope for government policy to make a difference. In addition, a serious retreat into protectionism would hurt the many groups that benefit from trade and would result in the same kind of social conflicts that globalization itself generates. We have to recognize that erecting trade barriers will help in only a limited set of circumstances and that trade policies will rarely be the best response to the problems that will be discussed here. Transfer and social insurance programs will generally dominate. In short, the genie cannot be stuffed back into the bottle, even if it were desirable to do so. We will need more imaginative and more subtle responses.

There are two dangers arising from complacency toward the social consequences of globalization. The first of these, and the more obvious, is a political backlash against trade. The candidacy of Patrick Buchanan in the Republican primaries of the 1996 presidential election revealed that protectionism can be a rather easy sell when broad segments of American society are experiencing anxieties linked, at least in part, to globalization. One wonders how much greater Buchanan's support would have been had the unemployment rate been, say, 10 percent rather than 5.6 percent. Economists may complain that protectionism is mere snake oil and argue that the ailments require altogether different medicine. But intellectual arguments will not win hearts and minds unless there are concrete solutions on offer. Trade protection, for all its faults, has the benefit of concreteness.

Perhaps future Buchanans will be ultimately defeated, as Buchanan himself was, by the common sense of the public. Even so, there is a second and perhaps even more serious danger: that globalization will contribute to social disintegration, as nations are split along lines of economic status, mobility, region, or social norms. Even without a protectionist backlash, a victory for globalization that comes at the price of social disintegration will be a very hollow victory indeed.

Social Disintegration as the Price of Economic Integration? If not handled well, then, the social pressures unleashed by global economic integration will likely result in bad economics and bad governance. This is not only because globalization highlights and exacerbates tensions among groups, which it does. It is also because it reduces the willingness of internationally mobile groups to cooperate with others in resolving disagreements and conflicts.

Far-sighted companies will tend to their own communities as they globalize. But an employer that has an "exit" option is one that is less likely to exercise the "voice" option. It is so much easier to outsource than to enter a debate on how to revitalize the local economy. This means that owners of internationally mobile factors become disengaged from their local communities and disinterested in their development and prosperity-just as suburban flight in an earlier era condemned many urban areas to neglect.

"[D]iverse groups [in society] hold together," wrote Bernard Crick, "because they practice politics-not because they agree about 'fundamentals,' or some such concept too vague, too personal, or too divine ever to do the job of politics for it. The moral consensus of a free state is not something mysteriously prior to or above politics: it is the activity (the civilizing activity) of politics itself.'"4 Or as Albert Hirschman put it, "The community spirit that is normally needed in a democratic market society tends to be spontaneously generated through the experience of tending the conflicts that are typical of that society."ls But what if globalization reduces the incentives to "tend" to these conflicts? What if, by reducing the civic engagement of internationally mobile groups, globalization loosens the civic glue that holds societies together and exacerbates social fragmentation?6

Hence globalization delivers a double blow to social cohesion-first by exacerbating conflict over fundamental beliefs regarding social organization and second by weakening the forces that would normally militate for the resolution of these conflicts through national debate and deliberation.

These developments are afflicting all societies exposed to globalization, with many developing countries perhaps even more exposed than the advanced industrial countries. A recent analysis of Mexican society by Jorge Castaneda is worth quoting extensively.7 Castaneda speaks of "a new cleavage that is rapidly cutting across Mexican society":

This split separates those Mexicans plugged into the US economy from those who are not.... It divides Mexicans who are highly sensitive to government macroeconomic policy from those who are indifferent to it. It separates those who correctly believe that politics and events in Mexico still determine their destiny from those who just as rightly understand that the decisions most critical to their lives are made in Washington and New York. It parts Mexicans who remain on the margins of global flows of capital, goods, and services, even if they are not on the margins of Mexican society, from those who are steadily being integrated into those flows. This growing group of Mexicans oriented toward the United States is isolated from much of the country's economic tribulation and relatively complacent about its political travails.18

With between one-fifth and one-quarter of the Mexican population tied into the world economy in this fashion, Castaneda doubts that a social explosion will happen. But, as he emphasizes, the presence of this group also makes meaningful reform less likely: "[W] ithout a stake in political change, [the segments of Mexican society linked to the world economy] also have little reason to foster it.'"9 Castaneda's account vividly describes an extreme form of the syndromes associated with globalization cum social disintegration.

Markets are a social institution, and their continued existence is predicated on the perception that their processes and outcomes are legitimate. As Karl Polanyi pointed out more than 50 years ago, the international market is the only market that is not regulated by an overarching political authority.2 Consequently, transactions undertaken in the international marketplace carry the least inherent legitimacy. This in itself is an ongoing source of tension between globalization and society. The problem becomes much worse when segments of society are perceived as having broken their links with their local communities and become footloose. Institutions that lose their legitimacy can no longer function, and markets are no different.

As John Ruggie put it, "In some respects . . . the world [today] finds itself faced with a challenge which is not unlike the one it faced in 1945: devising compatible forms of international liberalization and domestic stability."2' That challenge is augmented by some key difficulties. The United States is neither willing nor able to play the kind of leadership role it did in the immediate aftermath of World War II, and there is no alternative leader. Perhaps more seriously, there is a lack of clear strategies on which to proceed, even if the United States or another country were to provide the leadership.

The Role of Economists

There is a big role in this for economists. International economists in particular have been too Panglossian about the consequences of globalization. Their approach on the labor-market consequences of trade, one area in which they have actually engaged in the debate, has been too narrow, resulting in a tendency to downplay the role of trade. They have been too quick to paint those who have taken a more concerned stance as ignorant of economics or as closet protectionists (and sometimes both). Largely as a consequence, they have shut themselves out of the broader policy debate. This is a pity because economics has much to contribute here.

For example, there is much thinking to do on how to design appropriate policies and institutions that can best address the need to provide social insurance, which I have argued is a critical complement to the expansion of global markets. As a general principle, the better targeted the policies are to the sources of the problem, the less cost they will entail. If the external risks that buffet national economies and workers were fully observable, a set of transfers contingent on the realization of the shocks would work best. But the world is obviously too complicated for first-best solutions, and realistically we will have to sacrifice some efficiency. So economists can help develop practical alternatives that provide some insulation for the most affected groups without blunting market incentives entirely. It is not entirely clear what role trade policy should play in this, if any at all.22

Similarly, the mobility of capital and of employers both aggravate the risks immobile groups face and render it more difficult to generate the public resources needed to finance social insurance schemes. If this results in globalization coming up against social and political constraints and a backlash against trade, the mobility of employers creates a worldwide negative externality. A logical implication is that some taxation of footloose factors at the global level, with revenue sharing among nations, may be worth considering. There is a parallel here with the ongoing discussion of the Tobin tax, with the difference that the current idea applies to physical (rather than financial) capital. Once again, there is much thinking to do about the rationale and design of such a policy.

Finally, economists can draw on the literatures on institutional economics and political economy to formulate designs for a new system of global safeguards. As I will argue further below, addressing the concerns discussed here will likely require a mixture of greater multilateral discipline and broader access to an escape clause. The challenge is to enable countries that are willing to engage in greater harmonization of domestic policies to do so, while also allowing them to selectively delink from international obligations when these obligations come into conflict with domestic norms or institutions. How best to achieve this is an exciting intellectual challenge, with potentially large practical payoffs.

Hence economists could play a much more constructive role if they were to recognize that the tensions between social stability and globalization are real. They could help develop the conceptual frameworks needed for rethinking the roles of governments and of international institutions in this new phase of the global economy. They could assist policymakers in finding the tools and instruments needed to achieve policy objectives rather than taking issue with the objectives or denying that the problems exist.

By becoming engaged in this broader debate, economists can establish greater credibility with the public as they attempt to clear up the misunderstandings that opponents of trade often propagate. Keeping the debate honest and grounded on solid empirical evidence is a natural role for economists.

William Greider's recent book, One World, Ready or Not-The Manic Logic of Global Capitalism, illustrates the appeal of many popular misconceptions for some commentators.23 One of the main themes of Greider's book-that the global expansion of markets is undermining social cohesion and moving the world inexorably toward a major economic and political crisis-might be viewed simply as a bolder expression of the potential danger I have highlighted here. Certainly, I am in sympathy with many of Greider's concerns-the consequences for low-skilled workers in the advanced industrial countries, the weakening of social safety nets, and the repression of political rights in some leading exporters such as China and Indonesia. However, the book's disregard for sound economic analysis and for systematic empirical evidence makes it a very unreliable treatise on what is happening and a faulty manual for setting things right.

The misconceptions that crop up in Greider's book are easy ones for economists to correct. Greider is wrong, for example, in thinking that low wages are the driving force behind today's global commerce. If that were so, the world's most formidable exporters would be Bangladesh and a smattering of African countries. What he fails to take into account is the importance of differences among countries in labor productivity. Furthermore, Greider is wrong to attribute the U.S. trade deficit to the "unbalanced behavior" of U.S. trade partners.24 If commercial policies determined trade imbalances, India, until recently one of the world's most protectionist countries, would have been running large trade surpluses. It is a mistake to claim that "the global economy [is] now a losing transaction for the nation as a whole" because the United States' net factor payments abroad are positive.25 It is far from true that outward-oriented industrialization in Southeast Asian countries has made life worse rather than better for the former farmers who now toil in factories. It is generally not the case that foreign-owned companies in developing countries provide inferior working conditions to those that are available elsewhere in the economy; in fact, the reverse is more often true.

Greider is particularly wrong in thinking that global capitalism inevitably generates excess supply. This is the book's key argument and ultimately the main reason Greider believes the system will self-destruct. Consider his discussion of Boeing's outsourcing of some of its components to the Xian Aircraft Company in China:

[W]hen new production work was moved to Xian from places like the United States, the global system was, in effect, swapping highly paid industrial workers for very cheap ones. To put the point more crudely, Boeing was exchanging a $50,000 American machinist for a Chinese machinist who earned $600 or $700 a year. Which one could buy the world's goods? Thus, even though incomes and purchasing power were expanding robustly among the new consumers of China, the overall effect was an erosion of the world's potential purchasing power. If one multiplied the Xian example across many factories and industrial sectors, as well as other aspiring countries, one could begin to visualize why global consumption was unable to keep up with global production.26

The argument makes little sense, as any economist could point out. The Chinese worker who earns only a tiny fraction of his American counterpart will likely demonstrate commensurately lower productivity. Even if this were not the case and the Chinese workers' wages were repressed below what their productivity ought to bring them, the result is a transfer in purchasing power-to Boeing's shareholders and the Chinese employers-and not a diminution of purchasing power. Perhaps Greider is thinking that Boeing's shareholders and the Chinese employers have a lower propensity to consume than the Chinese workers. But if this is Greider's reasoning, where is the argument and the evidence? Where is the global surplus in savings and the secular decline in real interest rates that we would surely have observed if income was shifting from low savers to high savers?

It may be unfair to pick on Greider, especially as some of his other conclusions are worth taking seriously. But the misunderstandings that his book displays are commonplace in the globalization debate and do not advance it. Professional economists have a duty to expose these misunderstandings and explicate them to a broader audience. But to become true honest brokers, economists must demonstrate more modesty, less condescension, and a willingness to broaden their focus.

The Role of Labor Advocates

There should be little doubt in the reader's mind by now that I am sympathetic to the difficulties experienced by workers in a globalized economy. Indeed, where low-skilled or less-educated workers are concerned, trade operates in a less benign fashion than most trade economists concede. Policymakers have to be cognizant of this and design their trade and other policies accordingly. But there is a major responsibility here for labor groups as well.

The political salience of labor's voice in the United States (and to a lesser extent in Europe) is currently diminished by at least three forces. First, the same pressures that reduce the bargaining power of labor in the workplace also reduce its power in the political marketplace. As governments increasingly compete for footloose enterprises and capital, the interests of workers (who after all have nowhere else to go) are relegated to second place. "Competitiveness" becomes another word for labor costs, something that can be enhanced by slashing benefits and wages. Second, the excessive attachment of labor to a single political party in the United States (and the United Kingdom) diminishes its political power. Political parties are naturally more responsive to the interests of those who are ready to shift their allegiances to competing parties than they are to the interests of captive groups.27 Third, the receptivity of the general public to the ideas of labor advocates is greatly reduced by the protectionist tenor that too often characterizes these ideas.

Labor groups cannot do much about the first of these factors. The second may also be difficult to change. Where labor advocates can make the greatest difference is in distancing themselves from protectionist ideas. This would result in the advocacy of a more pragmatic and therefore more productive approach to trade policy. It would also lay the groundwork for the political repositioning needed to make political parties from both ends of the spectrum compete for the support of labor. Hence jettisoning protectionist ideas would not only serve labor interests better, it would also enhance labor's political power.

These protectionist ideas find expression most frequently in complaints about "low-wage, low-cost competition" from developing countries. But such broad condemnations of trade miss the mark. They ignore the fact that much of the difference in labor costs is typically due to lower levels of labor productivity in the exporting countries. Wages in a poor exporting country that are one-tenth the U.S. level do not disadvantage workers in the United States when labor productivity in that country is also lower by a factor of 10.28 More broadly, gaps in labor costs that are due to differences in the relative abundance of labor across countries are the foundation for the gains from trade. It makes as little sense to restrict trade for this reason alone as it does to restrict technological progress.

Consider, for example, the following statement by an AFL-CIO representative:

We spend a great deal of time talking about free trade and comparative advantages, and so forth, and I am sure these are important concepts and certainly we in the US labor movement subscribe to them. Labor has benefited greatly from freeness and free trade, not only internationally, but domestically, from the comparative advantages that result from having a productive society as large and as diverse as we do in the United States, but the American labor movement has always taken the position that, to the maximum extent possible, labor costs should be removed from that equation, because labor is more than just a cost of production. Labor involves human dignity; it involves another whole dimension than does capital or interest or the other factors of production, and it therefore has to be treated very differently from them. [emphasis added]29

"Removing labor costs from the equation," as this statement calls for, would remove the primary source of comparative advantage for developing countries and would deprive the U.S. economy of the gains from trade arising from it.

To the extent that there are concerns about fairness, the issue is not labor costs per se, but how they are determined. Popular discussions of trade often gloss over this distinction. In any case, the main competitive threat to U.S. labor, except in some highly labor-intensive sectors, comes from workers in other advanced countries, many of which have labor standards and benefit levels that are superior to those in the United States.

Hence the labor movement cannot afford to be-or to be perceived as being-against trade. This requires recognition by labor unions that imports go together with exports. One cannot be in favor of exports and against imports without committing mercantilist fallacies. Similarly, labor advocates have to accept that trade deficits are the consequence of macroeconomic realities; they have little to do with trade policies abroad, and they cannot be corrected by trade restrictions at home. The sooner the labor movement sheds such misconceptions, the sooner it will find allies in the economics and policy community.

Labor should advocate a global economy that carries a more humane face-one that recognizes national diversity and leaves room for national differences in institutions. Domestically, it should work toward labor-market institutions that enhance the mobility of workers and reduce the risks they face.

The Role of National Governments

Policymakers have to steer a difficult middle course between responding to the concerns discussed here and sheltering groups from foreign competition through protectionism. I can offer no hard-and-fast rules here, only some guiding principles.

Strike a Balance between Openness and Domestic Needs

There is often a trade-off between maintaining open borders to trade and maintaining social cohesion. When the conflict arises-when new liberalization initiatives are under discussion, for example-it makes little sense to sacrifice social concerns completely for the sake of liberalization. Put differently, as policymakers sort out economic and social objectives, free trade policies are not automatically entitled to first priority.

Thanks to many rounds of multilateral trade liberalization, tariff and nontariff restrictions on goods and many services are now at extremely low levels in the industrial countries. Most major developing countries have also slashed their trade barriers, often unilaterally and in conformity with their own domestic reforms. Most economists would agree that the efficiency benefits of further reductions in these existing barriers are unlikely to be large. Indeed, the dirty little secret of international economics is that a tiny bit of protection reduces efficiency only a tiny bit. A logical implication is that the case for further liberalization in the traditional area of manufactured goods is rather weak.30

Moreover, there is a case for taking greater advantage of the World Trade Organization's existing escape clause, which allows countries to institute otherwise-illegal trade restrictions under specified conditions, as well as for broadening the scope of these multilateral safeguard actions (see discussion below). In recent years, trade policy in the

United States and the European Union has gone in a rather different direction, with increased use of antidumping measures and limited recourse to escape clause actions. This is likely because WTO rules and domestic legislation make the petitioning industry's job much easier in antidumping cases: there are lower evidentiary hurdles than in escape clause actions,31 no determinate time limit, and no requirement for compensation for affected trade partners, as the escape clause provides. Also, escape clause actions, unlike antidumping duties, require presidential approval in the United States. This is an undesirable situation because antidumping rules are, on the whole, consistent neither with economics principles nor, as discussed below, with fairness. Tightening the rules on antidumping in conjunction with a reconsideration and reinvigoration of the escape clause mechanism would make a lot of sense.32

Do Not Neglect Social Insurance

Policymakers have to bear in mind the important role that the provision of social insurance, through social programs, has played historically in enabling multilateral liberalization and an explosion of world trade. As the welfare state is being pruned, there is a real danger that this contribution will be forgotten.

This does not mean that fiscal policy has to be profligate and budget deficits large. Nor does it mean a bigger government role. Enhanced levels of social insurance, for better labor-market outcomes, can be provided in most countries within existing levels of spending. This can be done, for example, by shifting the composition of income transfers from old-age insurance (i.e., social security) to labor-market insurance (i.e., unemployment compensation, trade adjustment assistance, training programs). Because pensions typically constitute the largest item of social spending in the advanced industrial countries, better targeting of this sort is highly compatible with responsible fiscal policies. Gearing social insurance more directly toward labor markets, without increasing the overall tax burden, would be one key step toward alleviating the insecurities associated with globalization.

There is a widespread feeling in many countries that, in the words of Tanzi and Schuknecht, "[s]ocial safety nets have . . . been transformed into universal benefits with widespread free-riding behavior, and social insurance has frequently become an income support system with special interests making any effective reform very difficult."33 Further, "various government performance indicators suggest that the growth in spending after 1960 may not have brought about significantly improved economic performance or greater social progress."34 However, social spending has had the important function of buying social peace. Without disagreeing about the need to eliminate waste and reform in the welfare state more broadly, I would argue that the need for social insurance does not decline but rather increases as global integration increases. So the message to reformers of the social welfare system is, don't throw the baby out with the bath water.35

Do Not Use "Competitiveness" as an Excuse for Domestic Reform

One of the reasons globalization gets a bad rap is that policymakers often fall into the trap of using "competitiveness" as an excuse for needed domestic reforms. Large fiscal deficits or lagging domestic productivity are problems that drag living standards down in many industrial countries and would do so even in closed economies. Indeed, the term "competitiveness" itself is largely meaningless when applied to whole economies, unless it is used to refer to things that already have a proper name-such as productivity, investment, and economic growth. Too often, however, the need to resolve fiscal or productivity problems is presented to the electorate as the consequence of global competitive pressures. This not only makes the required policies a harder sell-why should we adjust just for the sake of becoming better competitors against the Koreans or the Mexicans?-it also erodes the domestic support for international trade-if we have to do all these painful things because of trade, maybe trade isn't such a wonderful thing anyhow!

The French strikes of 1995 are a good case in point. What made the opposition to the proposed fiscal and pension reforms particularly salient was the perception that fundamental changes in the French way of life were being imposed for the sake of international economic integration. The French government presented the reforms as required by the Maastricht criteria, which they were. But presumably, the Maastricht criteria themselves reflected the policymakers' belief that a smaller welfare state would serve their economies better in the longer run. By and large, the French government did not make the case for reform on its own strengths. By using the Maastricht card, it turned the discussion into a debate on European economic integration. Hence the widespread public reaction, which extended beyond just those workers whose fates would be immediately affected.

The lesson for policymakers is: do not sell reforms that are good for both the economy and the citizenry as reforms that are dictated by international economic integration.

Do Not Abuse "Fairness" Claims in Trade

The notion of fairness in trade is not as vacuous as many economists think. Consequently, nations have the right-and should be allowed-to restrict trade when it conflicts with widely held norms at home or undermines domestic social arrangements that enjoy broad support.

But there is much that is done in the name of "fair trade" that falls far short of this criterion. There are two sets of practices in particular that should be immediately suspect. One concerns complaints made against other nations when very similar practices abound at home. Antidumping proceedings are a clear example: standard business practices, such as pricing over the life of a product or pricing over the business cycle, can result in duties being imposed on an exporting firm. There is nothing "unfair" about these business practices, as is made abundantly clear by the fact that domestic firms engage in them as well.

The second category concerns cases in which other nations are unilaterally asked to change their domestic practices so as to equalize competitive conditions. Japan is frequently at the receiving end of such demands from the United States and the European Union. A more recent example concerns the declaration by the U.S. Trade Representative that corruption in foreign countries will henceforth be considered as unfair trade. While considerations of fairness and legitimacy will guide a country's own social arrangements, even by restricting imports if need be, such considerations should not allow one country to impose its own institutions on others. Proponents of fair trade must bear this key distinction in mind. Thus, it is perfectly legitimate for the United States to make it illegal for domestic firms to engage in corrupt practices abroad (as was done with the Foreign Corrupt Practices Act of 1977). It is also legitimate to negotiate a multilateral set of principles with other countries in the Organization for Economic Cooperation and Development (OECD) with broadly similar norms. It may also be legitimate to restrict imports from a country whose labor practices broad segments of the domestic population deem offensive. But it is not acceptable to unilaterally threaten retaliation against other countries because their business practices do not comply with domestic standards at home in order to force these countries to alter their own standards.36 Using claims of fairness to advance competitive aims is coercive and inherently contradictory. Trying to "export" norms by asking other countries to alter their social arrangements to match domestic ones is inappropriate for the same reason.

The Role of International Institutions

One area in which international cooperation can be helpful has already been mentioned: the ability of firms to play national tax authorities off each other is a source of negative cross-border externality, as it undercuts the revenue sources needed to maintain social and political cohesion and ultimately erodes support for free trade. Greater exchange of information among tax authorities would be one small step in the right direction. Negotiating an international convention to restrict international firms' ability to evade taxation via foreign investment would constitute a more ambitious effort, but one that would have a greater chance of making a difference.

There is a growing realization among governments that something along these lines may need to be done. Concern about the revenue consequences of tax competition recently led the OECD to set up a task force (with priority funding) on curbing such competition among its member states. As the OECD statement recognizes, globalization "opens up the risk of competitive bidding between countries for mobile business." The task force's first task is to "examine criteria for distinguishing between fair and harmful tax competition."37 To be fully effective, such an effort has to enlist the cooperation of non-OECD countries as well. This is implicit in the OECD's approach, as its task force is slated to look at practices in such tax havens as the Cayman Islands as well as the more modest preferential tax regimes of countries such as Ireland, the Netherlands, and Belgium.

More broadly, the arguments made here have two somewhat conflicting implications for multilateral institutions. On the one hand, these institutions must encourage greater convergence of policies and standards ("deep integration") among willing countries to help reduce tensions arising from differences in national practices.39 On the other, they must make room for selective disengagement from multilateral disciplines, under well-specified contingencies, for countries that need breathing room to satisfy domestic requirements that are in conflict with liberalizing trade.

The apparent tension between these two objectives is partly reconciled by the caveat in the previous sentence. These organizations will need to set up a well-defined and multilaterally agreed set of hurdles that must be cleared before a nation can exercise the selective disengagement in question-be it higher tariffs, a quota, or an exemption from harmonization requirements. In other words, there need to be multilateral rules on how one can depart from multilateral rules!40

Of course, this is what the escape clause mechanism under the WTO, and before it the General Agreement on Tariffs and Trade (GATT), is in principle all about. But the mechanism has not served its purpose well. Governments have preferred other measures to the GATT's safeguard mechanism. Hence "gray area" measures, such as voluntary export restraints (VERs), proliferated before the Uruguay Round ended, and there has been an explosion of antidumping cases. There were only 150 official safeguard actions under the GATT (through 1994) but more than 1,000 antidumping cases at the national level between 1985 and 1992 alone.4' Antidumping procedures are today effectively serving as the safeguard mechanism of choice. This subverts the trade regime, gives safeguards a bad name, and crowds out an effective outlet for legitimate concerns.

Hence, a revamped and expanded safeguards clause, along with tighter restrictions on the use of antidumping, would be well worth considering.42 By broadening the current Agreement on Safeguards, WTO members can then allay U.S. and EU fears of import surges, which have so far prevented the reining in of antidumping measures.

Currently, the Agreement on Safeguards allows temporary increases in trade restrictions under a very narrow set of conditions. It requires a determination that increased imports "cause or threaten to cause serious injury to the domestic industry"43 and that causality is firmly established. Furthermore, injury cannot be attributed solely to imports if there are multiple causes for it.44 Safeguards cannot be applied to developing-country exporters unless their share of imports of the product concerned is above a given threshold. A country applying safeguard measures has to compensate the affected exporters by providing "equivalent concessions," lacking which the exporter is free to retaliate.

A broader interpretation of safeguards would acknowledge that countries may legitimately wish to restrict trade for reasons going beyond competitive threats to their industries. Distributional concerns or conflicts with domestic norms or social arrangements are among such legitimate reasons. One could imagine recasting the current agreement into an Agreement on Social Safeguards, which would permit the application of safeguard measures under a broader range of circumstances. This would require recasting the "serious injury" test. I would replace the injury criterion with another hurdle: the need to demonstrate broad domestic support, among all concerned parties, for the proposed safeguard measure.

To see how that might work in practice, consider what the current agreement says:

A Member may apply a safeguard measure only following an investigation by the competent authorities of that Member pursuant to procedures previously established and made public in consonance with Article X of the GATT 1994. This investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which importers, exporters and other interested parties could present evidence and their views, including the opportunity to respond to the presentations of other parties and to submit their views, inter alia, as to whether or not the application of a safeguard measure would be in the public interest [emphasis added]. The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law.

The main shortcoming of this clause is that while it allows all relevant groups, exporters and importers in particular, to air their views, it does not actually compel them to do so. Consequently, it results in a strong bias in the domestic investigative process toward the interests of import-competing groups, which are the petitioners for import relief and its obvious beneficiaries. Indeed, this is a key problem with hearings in antidumping proceedings, where testimony from other groups besides the import-competing industry is not allowed.

A key reform, then, would be to require those conducting the investigations in each country to gather testimony and views from all relevant parties, including consumer and public interest groups, importers of the products concerned, and exporters to the affected country, and to determine whether there exists broad support among these groups for the application of the safeguard measure in question. The requirement that groups whose incomes would be hurt by imposing trade restrictions-importers and exporters-be compelled to testify and that the investigative body determine whether these groups also support the safeguard measure would ensure that protectionism pure and simple would not have much chance of success. At the same time, when deeply and widely held social norms are at stake, these groups are unlikely to oppose safeguards in a public manner, as this would endanger their standing among the public at large. Imagine, for example, that slave labor is used in producing goods for export in a given country. It is difficult to believe that exporters to that country would publicly defend trade with it.

The main advantage of the proposed procedure is that it would force a public debate on the legitimacy of trade and on the appropriateness of restricting it. It ensures that all sides would be heard. This rarely happens in practice, unless the trade partner in question is an important one.45 This procedure could also be complemented with a strengthened monitoring and surveillance role for the WTO to ensure that domestic procedures are in compliance with the expanded safeguard clause. An automatic sunset clause could ensure that trade restrictions do not become entrenched long after their perceived need has disappeared.

Broadening safeguard actions in this manner would not be without its risks. One has to take into account the possibility that the new procedures would be abused for protectionist ends and that the door to unilateral action on a broad front would be opened, despite the high threshold envisaged here. But inaction is not without risk either. Absent creative thinking and novel institutional designs, the tensions created by globalization may spark a new set of "gray area" measures entirely outside multilateral disciplines. That would be far worse than the revised safeguard regime described here.

Concluding Remarks

Globalization is not occurring in a vacuum. It is part of a broader trend that we may call marketization. Receding government, deregulation, and the shrinking of social obligations are the domestic counterparts of the intertwining of national economies. Globalization could not have advanced this far without these complementary forces. The broader challenge for the 21st century is to engineer a new balance between market and society, one that will continue to unleash the creative energies of private entrepreneurship without eroding the social basis of cooperation.

The tensions between globalization and social cohesion are real, and they are unlikely to disappear of their own accord. The proposals in this article are little more than a beginning, and perhaps not even that. There is no magic formula that can be applied. Indeed, part of the difficulty in thinking prescriptively about these issues is that some of the basic analytical and empirical work on the consequences of globalization remains to be done. Contrary to what many economists believe, we lack a full understanding of how globalization works.

"What is actually required to make progress with novel problems a society encounters," writes Albert Hirschman, "is political entrepreneurship, imagination, patience here, impatience there, and other varieties of virtu and fortuna."46 We need all of these, plus a good dose of pragmatism, to make progress on the challenges ahead.

Notes

1. See the perceptive column by Thomas L. Friedman, "Don't Leave Globalization's Losers Out of Mind," International Herald Tribune, July 18, 1996. Friedman stresses that the recent salience of such apparently diverse political movements as that of Patrick Buchanan in the United States, Communists in Russia, and the Islamists in

Turkey may be due to a common root: a backlash against globalization. I thank Robert Wade for bringing Friedman's piece to my attention. 2. The cheerleaders on the side of globalization sometimes make for strange bedfellows too. Consider, for example, the philosophy of an organization called the Global Awareness Society International: "Globalization has made possible what was once merely a vision: the people of our world united together under the roof of one Global Village." See, for example, Amitai Etzioni, The Spirit of Community: The Reinvention of American Society (New York, NY: Simon & Schuster, 1994); Michael J. Sandel, Democracy 's Discontent: America in Search of a Public Philosophy (Cambridge, MA: Harvard University Press, 1996). 3. See also **Ethan Kapstein**, "Workers and the World Economy," Foreign Affairs, 75/3 (May/June I996); Raymond Vernon, "In the Hurricane's Eye: Multinational Enterprises in the Next Century," unpublished manuscript, Harvard University. **Kapstein** argues that a backlash from labor is likely unless policymakers take a more active role in managing their economies. Vernon argues that we might be at the threshold of a global reaction against the pervasive role of multinational enterprises.

4. Jagdish Bhagwati and Paul Krugman are two economists who have been tireless in exposing common fallacies in discussions on international trade. See, in particular, Jagdish N. Bhagwati, Protectionism (Cambridge, MA: MIT Press, 1988); Paul Krugman, Pop Internationalism (Cambridge, MA: MIT Press, 1996). 5. When I mention "economists" here, I am, of course, referring to mainstream economics, as represented by neoclassical economists (of which I count myself as one).

6. Cline provides an excellent review of the literature. William R. Cline, Trade and Wage Inequality (Washington, D.C.: Institute for International Economics, 1997). See also Susan Collins, ed., Imports, Exports, and the American Worker (Washington, D.C.: Brookings Institution, 1996).

7. Outsourcing refers to companies' practice of subcontracting part of the production process-typically the most labor-intensive and least skill-intensive parts-to firms in other countries with lower costs.

8. Jeffrey Williamson, "Globalization and Inequality Then and Now: The Late l9th and Late 20th Centuries Compared," Working Paper No. 5491, National Bureau of Economic Research, 1996. 9. Ibid.

10. Ibid., p. 19. 11. Ibid., p. 1. 12. Ibid., p. 20.

13. Douglas A. Irwin, "The United States in a New Global Economy: A Century's Perspective," American Economic Review Papers and Proceedings, 86/2 (May 1996): 42.

14. Bernard R. Crick, In Defence of Politics (Chicago, IL: University of Chicago Press,

1962), p. 24.

15. Albert O. Hirschman, "Social Conflict as Pillar of Democratic Society," Political Theory, 22/2 (May 1994): 25.

16. Here the debate on globalization joins the debate on social capital. Robert Putnam, "The Strange Disappearance of Civic America," The American Prospect, 24 (Winter 1996): 34-48. Putnam documents a significant decline in civic participation in the United States, and attributes it, in large part, to television. There is now considerable empirical evidence that suggests social fragmentation is detrimental to economic performance. Alesina and Rodrik, among others, show that income inequality reduces subsequent economic growth, Knack and Keefer find levels of social trust to be positively correlated with investment, and Easterly and Levine

find a strong negative correlation between an index of ethnolinguistic fragmentation and subsequent levels of economic growth. Alberto Alesina and Dani Rodrik, "Distributive Politics and Economic Growth," Quarterly Journal of Economics, 109/2 (May 1994): 465-490; Stephen Knack and Philip Keefer, "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation," unpublished paper, American University, 1996; William Easterly and Ross Levine, "Africa's Growth Tragedy: Policies and Ethnic Divisions," unpublished paper, World Bank, Washington, D.C., 1996.

17. Jorge Castaneda, "Mexico's Circle of Misery," Foreign Affairs, 75/4 (July/August 1996): 92-105. 18. Ibid., p. 95. 19. Ibid., p. 100.

20. Karl Polyani, The Great Transformation (Boston, MA: Beacon Press, 1944). 21. John G. Ruggie, "At Home Abroad, Abroad at Home: International Liberalization and Domestic Stability in the New World Economy," Millennium: Journal of International Studies, 24/3 (1995): 508.

22. As expressed by Avinash Dixit in his comments on an earlier draft, "Designing more efficient systems of social insurance, tailored to the particular shocks that matter to particular countries, which will allow them

to secure more of the benefits of integration and suffer less of the social costs of it, is just the right kind of task for economists."

23. William Greider, One World, Ready or Not-The Manic Logic of Global Capitalism (New York, NY: Simon & Schuster, 1997). 24. Ibid., p. 205. 25. Ibid., p. 202. 26. Ibid., p. 155.

27. See Dixit and Londregan for a theoretical model that explicates this outcome. Avinash Dixit and John Londregan,"The Determinants of Success of Special Interests in Redistributive Politics," Journal of Politics (forthcoming). 28. Freeman finds that approximately 80 percent of the difference in hourly pay between the United States and Mexico is accounted for by differences in the skill mix of labor in the two countries and by differences in the purchasing power of wages. Richard Freeman, "A Global Labor Market? Differences in Wages among Countries in the 1980s," unpublished paper, 1994.

29. Cited by David W. Leebron, "Lying Down with Procrustes: An Analysis of Harmonization Claims," in Jagdish N. Bhagwati and Robert E. Hudec, Fair Trade and Harmonization: Prerequisites for Free Trade? Vol. 1: Economic Analysis (Cambridge, MA: MIT Press, 1996).

30. Of course, since trade barriers are still higher elsewhere than in the United States, multilateral liberalization would generate relatively greater trade opportunities for the United States. See Bergsten for an argument that emphasizes this "asymmetric" nature of the benefits. C. Fred Bergsten, "Globalizing Free Trade," Foreign Affairs, 75/3 (May/June 1996): 105-120.

31. In the United States, escape clause action requires demonstration of "serious injury" rather than "material injury," the latter being the lower threshold, which applies to antidumping. WTO rules also require that escape clause actions be nondiscriminatory, unlike antidumping, which can apply to any particular exporting country. Of course, an antidumping action requires a demonstration that there is dumping, but in practice U.S. Commerce Department criteria for what constitutes -dumping" are not at all restrictive.

32. This was one of the options considered by Schott. Jeffrey J. Schott, The Global Trade Negotiations: What Can Be Achieved? Policy Analyses in International Economics, 29 (Washington, D.C.: Institute for International Economics, 1990).

33. Vito Tanzi and Ludger Schuknecht, "The Growth of Government and the Reform of the State in Industrial Countries," IMF Working Paper WP/95/130, Washington, D.C., International Monetary Fund, 1995, p. 17. 34. Ibid., p. 20.

35. Many economists would agree that the amount of resources needed to keep the most disadvantaged from falling through the cracks is actually not that big. Krugman cites a figure of 2 percent of GDP. In absolute terms, this is, of course, a lot of money, but it is less than half of what an average OECD country spends on servicing the public debt each year. Krugman, op. cit.

36. It may be that restricting imports will cause the exporting country to alter its practices, irrespective of whether that was the stated goal of the policy. But that does not make the distinction any less valid. The motives that drive trade policy in the advanced industrial countries are usually transparent. There is little doubt that the Foreign Corrupt Practices Act of 1977, for example, was motivated by domestic ethical considerations, while many U.S. and European complaints against Japan and some developing countries are clearly driven by a desire to make "them" more like "us." How foreign trade partners choose to react to policies of the first kind (the "legitimate" actions, that is) is their own business. 37. The quotes are from the OECD's Internet statement on the project (see www.oecd.org/daf/fa/taxcomp.htm; Financial Times, January 13, 1997, p. 16. 38. Financial Times, January 13, 1997, p. 16.

39. Lawrence, Bressand, and Ito argue for the creation of a series of "clubs" among partners willing to engage in deeper integration in areas not well covered in the WTO-such as competition policy or

environment. This would be a departure from unconditional multilateralism and would risk institutionalizing discriminatory treatment of trade partners. I would prefer to see the WTO used for these new areas, with a more effective escape clause as a safety valve. Robert Z. Lawrence, Albert Bressand, and Takatoshi Ito, A Vision for the World Economy: Openness, Diversity, and Cohesion (Washington, D.C.: Brookings Institution, 1996).

40. It is recognized in the theory of repeated games that sustaining cooperation among players throughout a long (infinite) horizon when there are shocks to the system may require periods of "noncooperation.' An appropriate multilateral trading regime will recognize this and incorporate "safety valves" into its rulesthat is, exemptions from its requirements under specified contingencies. See Bagwell and Staiger for a formal model that justifies the escape clause in these terms. In the context of such models, my argument is that social conflicts result in a greater temptation to "defect" during bad times and hence require a more accessible escape clause to render long-term cooperation sustainable. Kyle Bagwell and Robert W. Staiger, "A Theory of Managed Trade,' American Economic Review, 4 (1990): 779-795.

41. Bernard M. Hoekman and Michael M. Kostecki, "The Political Economy of the

World Trading System," unpublished book manuscript, 1995, chapter 7. 42. A refurbished escape clause, under which all trade relief would be centered, was proposed in Hufbauer and Rosen. Gary C. Hufbauer and Howard F. Rosen, Trade Policy for Troubled Industries, Policy Analyses in International Economics, 15 (Washington, D.C.: Institute for International Economics, 1986). See also Perez-Lopez for a similar approach. Jorge F. Perez-Lopez, "Case for a GATT Code on Temporary Measures," The World Economy, 12/1 (March 1989): 53-67. My discussion of the expanded safeguards clause is based on earlier work reported in Dani Rodrik, "Developing Countries after the Uruguay Round," in UN Conference on Trade and Development, International and Monetary Issues for the 1990s, Vol. 6 (New York, NY: United Nations, 1995).

43. Serious injury is defined as "a significant overall impairment in the position of a domestic industry."

44. According to the agreement, When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports."

45. The public debate that surrounds the U.S. president's annual decision on whether to extend China's most-favored nation trade status is a good example. In my view, this debate serves a useful function. 46. Hirschman, op. cit., p. 25.